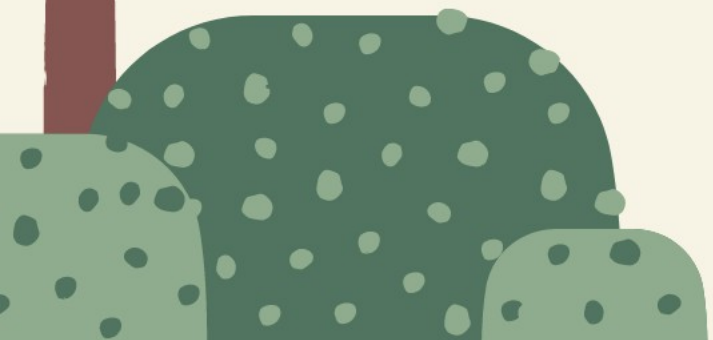
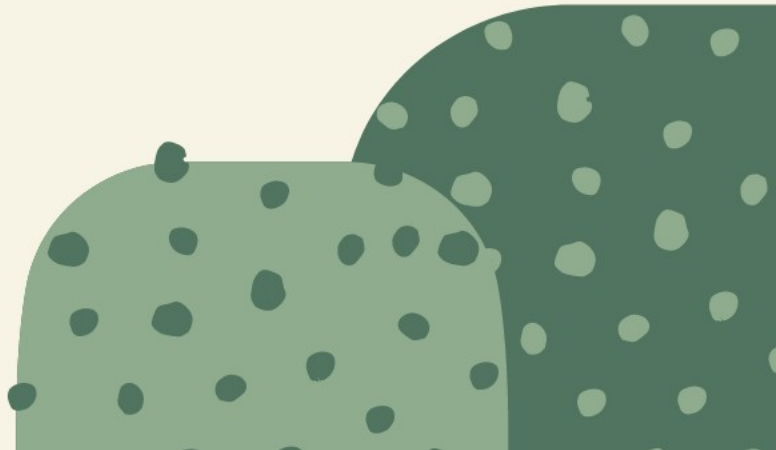
Welcome to today's topic!

IN APPLIED ECONOMICS

Economics as an Applied Science

CHAPTER 2

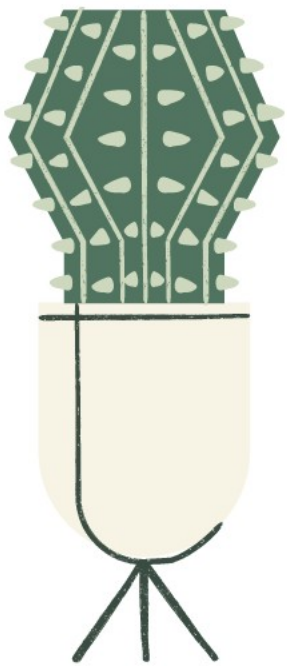




Are you ready to listen and learn?

Learning Objectives

At the end of this chapter, the learners will be able to:



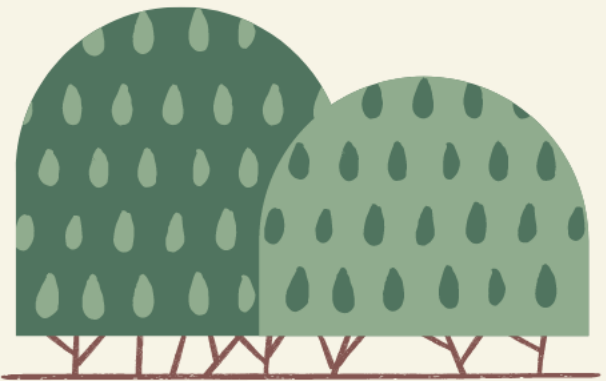
- understand applied economics;
- define the basic terms in applied economics;
- explain the meaning of economic theory;
- enumerate the different economic theories; and
- discuss the importance of the study of econometrics.

What is Applied Economics?

Applied Economics is the study of economics in relation to real life situations. It is the application of economic principles and theories to actual situations, and trying to predict what the outcomes might be. Simply put, applied economics is the study of observing how theories work in practice. Applied economics may be practiced at these two levels below:

Macroeconomic - the whole, aggregate economy

Microeconomic - analyzing individual consumers and companies



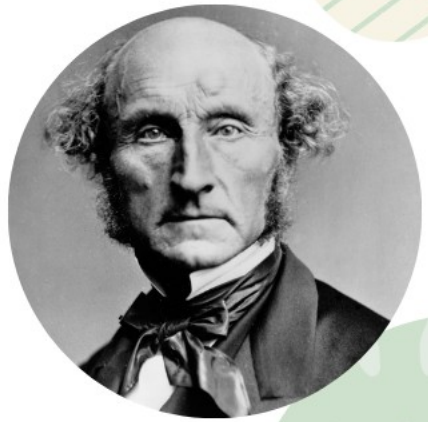
Did you know that...

It is believed that Applied Economics started to be used nearly 200 years ago, in the writing of French economist and businessman, **Jean-Baptiste Say** (1767-1832) who is famous for his Say's Law or the law of market, and of the British political economist, philosopher, and civil servant, **John Stuart Mill** (1806-1873).

Jean-Baptiste Say

Say wrote about applying the "general principles of political economy" to "ascertain the rule of action of any combination of circumstances presented to us".

Mill's (1848) work, on the other hand, is on the Principles of Political Economy with Some of Their Applications to Social Philosophy.



John Stuart Mill

Economic Theory vs Applied Economics

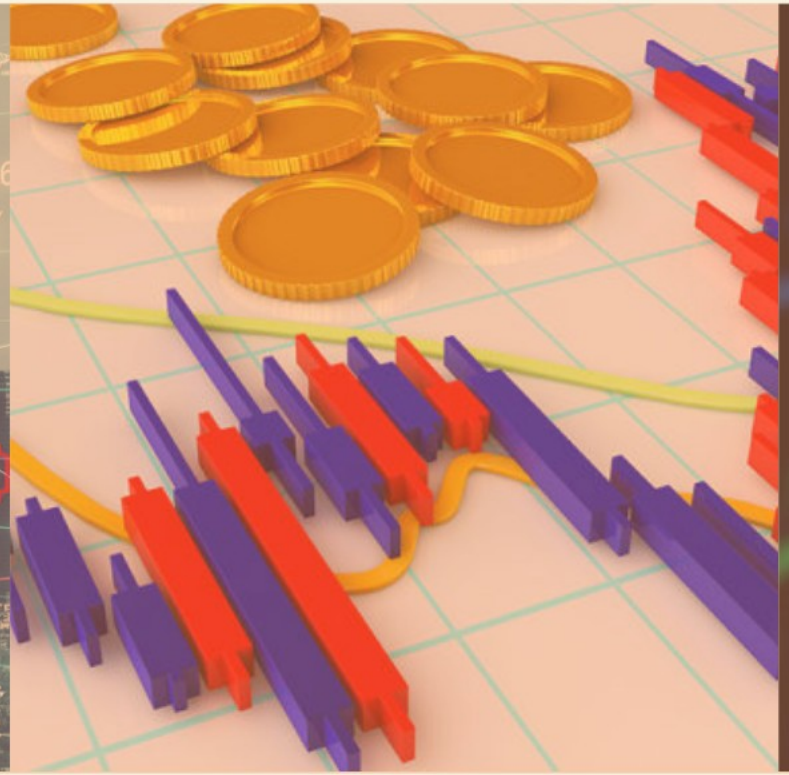
Always remember that Economic Theory is all about ***thinking things up***, while Applied Economics is about ***trying things out.***

Points to learn...

- Robust background in applied economics allows people to make informed forecasts about future trends.
- Knowledge in applied economics provides the student with a broader perspective on the application of economic theory to real world issues but less knowledge of core economic theory.
- Applied economics is the application of economic theory and econometrics in specific settings (Market Business News 2016)

early

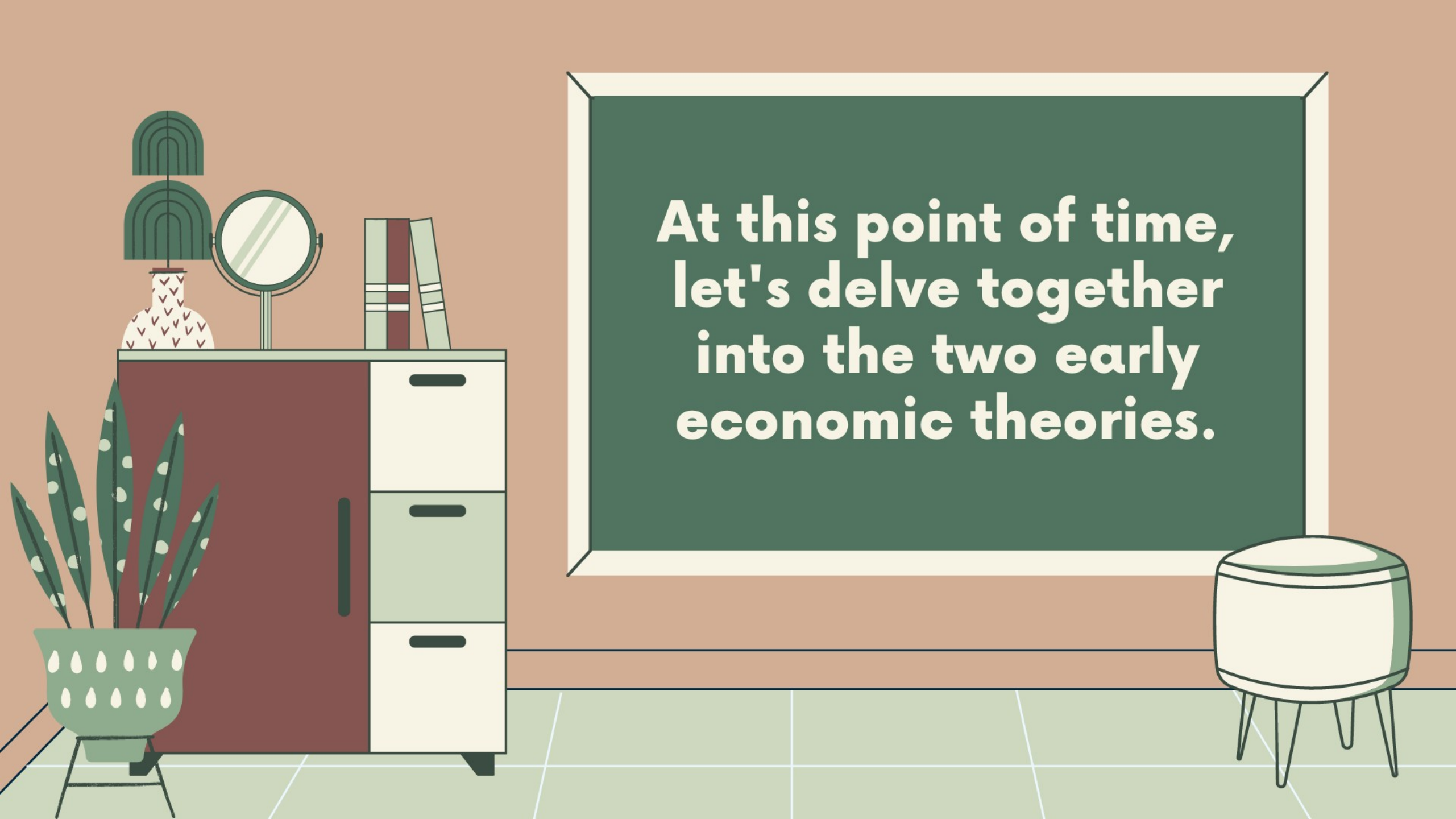
ECONOMIC THEORIES



Points to learn...

- Theory is defined as a well substantiated explanation of some aspects of the natural world.

- Economic Theory is defined as a theory on commercial activities such as the production and consumption of goods.


At this point of time, let's delve together into the two early economic theories.

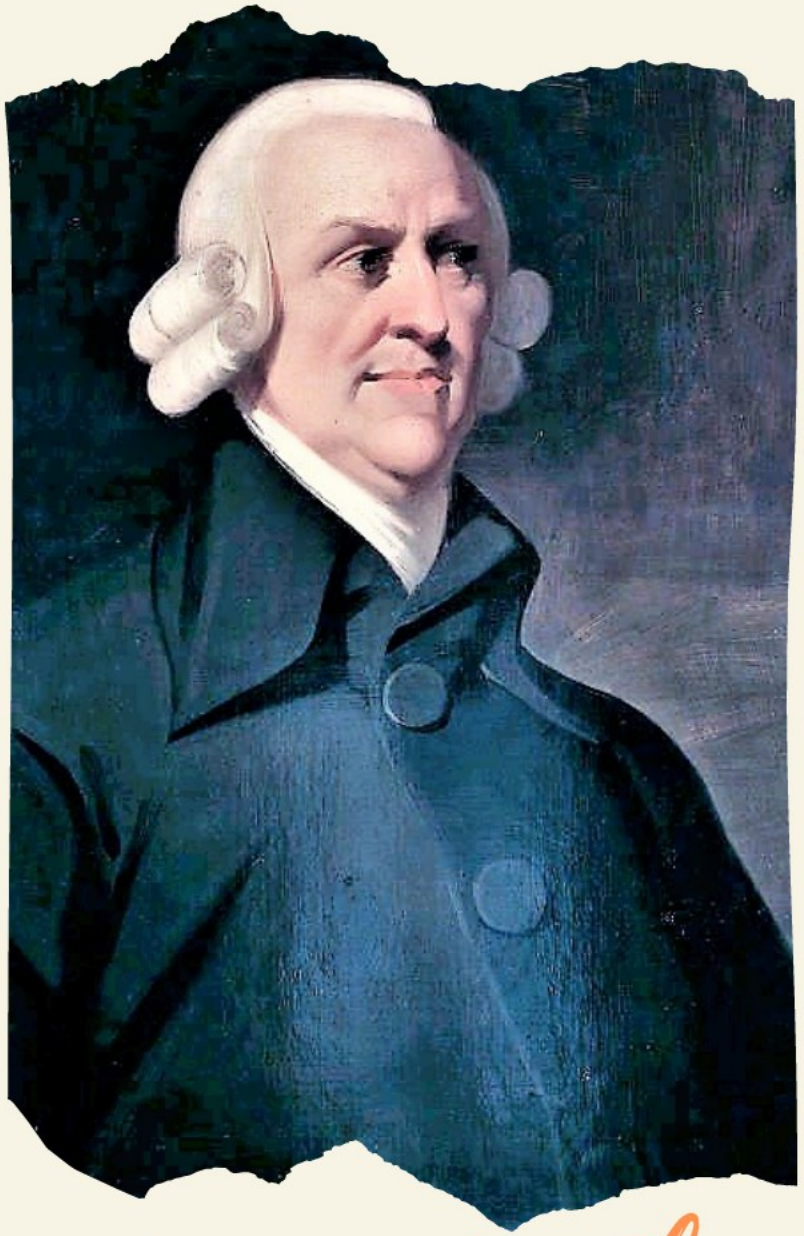
Thomas Robert Malthus

MALTHUSIAN THEORY OF POPULATION GROWTH

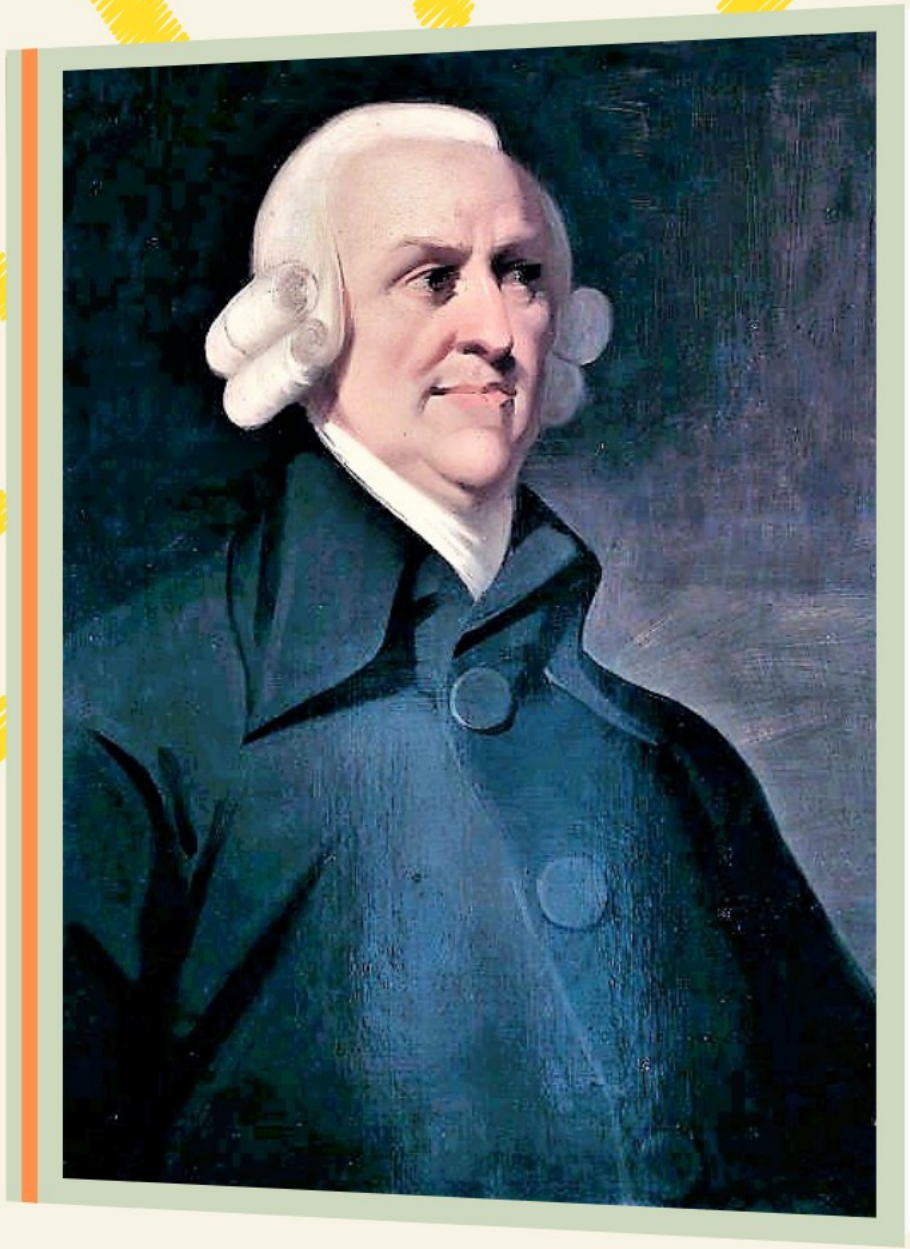
Thomas Robert Malthus, an English cleric and scholar, examined the relationship between population growth and resources. Example: If every member of a family tree reproduces, the tree will continue to grow with each generation.

ADAM SMITH AND THE WEALTH OF NATIONS

Adam Smith, a Scottish economist and philosopher, was a pioneer in political economy and modern economics. - His best-known work "An Inquiry into the Nature and Cause of the Wealth of Nations" commonly called " The Wealth of Nations " was published in 1776. The book offers a detailed description of life and trade in English society. It also scientifically describes the basic principles of economics.



Adam Smith



Economic Ideas of Adam Smith

- **Productivity and Wealth** – Smith observed that labor becomes more productive as each worker becomes more skilled at a single job. He also said that new machinery and the division and specialization of labor would lead to an increase in production and greater wealth for the nation.

- **Invisible Hand** – One of Smith's most important contributions deals with the competition in the marketplace. He argued that competition, together with the free market system, would act as an invisible hand that would guide resources to their most productive use. He also believed that under competitive conditions, individuals acting naturally in their own self-interest would bring the greatest good for society as a whole.

- **Laissez-Faire** - The Wealth of Nations was ridiculed by aristocracy in parliament at that time. Business people, however, were delighted to have a moral justification for their growing wealth power. Eventually, the doctrine of laissez-faire, meaning no government intervention in economic affairs, became the watchword of the day in Great Britain.

What is Free Market?

The **laissez-faire** is a doctrine that claims that an economic system should be free from government intervention or moderation, and be driven only by the market forces. It is centered on the belief that when humans are self-interested and, when they are not interfered, a balanced system of production and exchange, arises.

MODERN
ECONOMIC THEORIES

1. Consumerism- states that an increasing consumption of goods is economically beneficial.

2. Keynesianism- popularized by *John Maynard Keynes*, advocates government monetary and fiscal programs intended to stimulate business activity and increase employment.

3. Liberalism- advocates free competition and self- regulating market.

4. Monetarism- states that variation in unemployment and the rates of inflation are usually caused by changes in the supply of money.

5. Utilitarianism- bases the moral worth of an action upon the number of people who derive happiness or pleasure from it. It is used when making social, economic, or political decision for the "betterment of society."

What is Econometrics?

Econometrics is the application of statistical and mathematical theories in economics for the purpose of testing hypotheses and forecasting future trends. It takes economic models to be tested through statistical trials. The results are then compared and contrasted against real-life examples. Econometrics can be therefore be divided into two major categories: theorical and applied.

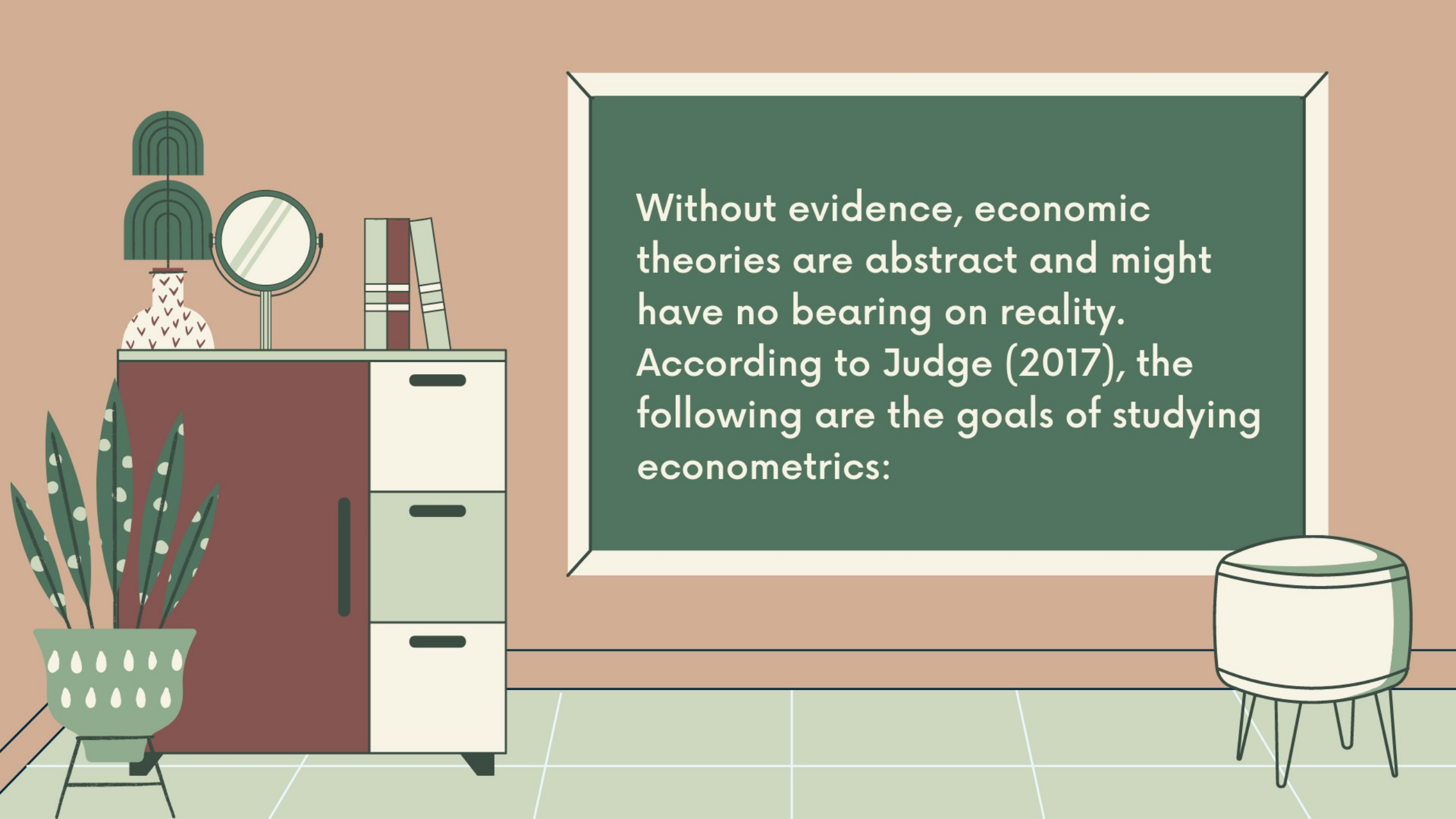
Points to learn...

- **Theoretical econometrics** uses a combination of economic theory, math, and statistical inferences to quantify and analyze economic theories by leveraging tools such as frequency distributions, probability and probability distributions, statistical inference, simple and multiple regression analysis, simultaneous equations models, and time series methods.

- An example of **real-life application of econometrics** would be to study to income effect. An economist may hypothesize that as a person increases his income, his spending will also increase. The hypothesis can be tested and proven using econometric tools like frequency distributions or multiple regression analysis.

GOALS OF

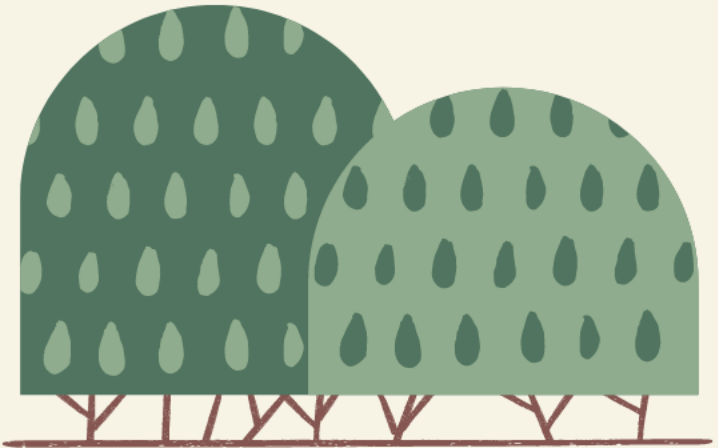
studying econometrics


Without evidence, economic theories are abstract and might have no bearing on reality. According to Judge (2017), the following are the goals of studying econometrics:

GOALS

The first goal is to test a hypothesis. It allows you to conduct applied econometric studies of your own, which can be very useful if you are also doing a dissertation.

The second goal is to critically assess the empirical work of others. This can be helpful when discussing the relevant academic literature in any other module and to be able to comment on why a particular technique may or may not be appropriate can often be impressive.



Have you learned something today?

That's all, thank you!